Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Review of the Commission's Rules	)	
Regarding the Pricing of	)	WC Docket No. 03-173
Unbundled Network Elements and the	)	
Resale of Service by Incumbent	)	
Local Exchange Carriers	)	
	)	

Comments of Communications Workers of America

Debbie Goldman
George Kohl
501 Third St. N.W.
Washington, D.C. 20001
(202) 434-1194 (phone)
(202) 434-1201 (fax)
debbie@cwa-union.org

Dated: December 16, 2003

The Communications Workers of America ("CWA") submits these comments in response to the Commission's Notice of Proposed Rulemaking ("NPRM") on the pricing of unbundled network elements (UNEs).[1] CWA represents more than 700,000 employees who work in all segments of the telecommunications industry and for other public and private sector organizations. CWA members are also consumers of telecommunications services.

CWA commends the Commission for initiating this inquiry and urges the Commission to act expeditiously to reform the UNE pricing rules. The Commission is well aware that the telecommunications sector is in a deep depression. Investment by wireline telecommunications carriers (both local and long-distance) declined from $104.8 billion in 2000 to $42.8 billion in 2002 – a reduction of over $60 billion in just two years.[2] According to the Telecommunications Industry Association, spending by carriers on telecommunications equipment decreased from $58 billion in 2000 to $22 billion in 2002.[3] The four Regional Bell Operating Companies ("RBOCs") reduced capital spending over the past two years by $30 billion.[4]

Over the same two-year period, approximately 900,000 jobs have been lost in the telecommunications and information industries.[5] More than 67,000 CWA-represented high-skill, good-paying frontline jobs at the four Bell companies, AT&T, Lucent, and Avaya have disappeared since January 2002.[6]

The UNE regime based on below-cost TELRIC (total element long-run incremental cost) prices is a major contributor to the depressed investment and job loss in the telecommunications

---

[1] Notice of Proposed Rulemaking, In the Matter of Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers ("NPRM"), WC Docket No. 03-173, Sept. 15, 2003 (rel).

[2] Skyline Marketing Group, *CapEx Report: 2002 Annual Report,* Carrier Data Sheet 1, June, 2003.

[3] TIA, *2003 Telecommunications Market Review and Forecast* at 56 – Tables II-4.1 and II-4.2 (2003).

[4] CWA calculation based on company SEC 10-K (2002) and 10-Q (3rd quarter 2003) reports.

sector. As the Commission notes in the NPRM, TELRIC pricing rules that result in understated forward-looking costs can "create incentives for carriers to avoid investment in facilities."[7] This is precisely what has happened in the local telecommunications sector under current UNE TELRIC pricing rules. Therefore, it is imperative that the Commission act expeditiously to reform the TELRIC pricing rules to send the correct signals to encourage infrastructure investment by incumbents and competitors alike and to create jobs in the telecommunications industry.

The TELRIC pricing methodology is deeply flawed. First, the network assumptions seriously understate actual forward-looking costs by basing cost assumptions on the attributes of a hypothetical rather than the existing network. CWA agrees with the Commission's tentative conclusion in the NPRM that the TELRIC rules should more closely account for the real-world attributes of the routing and topography of an incumbent's network in the development of forward-looking costs.[8] Further, CWA agrees with the Commission's tentative conclusion that the TELRIC rules should be based on an analysis that understands that the "most efficient network" is a mix of old and new technology.[9] The NPRM correctly states:

> (I)t is unlikely that any carrier, no matter how competitive the marketplace, would deploy new technology instantaneously and ubiquitously throughout its network. Even if the objective is to replicate the results of a competitive market, an approach that reconstructs the network over time seems to be more appropriate than one that assumes the instantaneous deployment of 100 percent new technology.[10]

In addition, the Commission should adopt a forward-looking cost methodology for TELRIC prices that acknowledges that in a competitive market, depreciation rules should be

---

[5] U.S. Bureau of Labor Statistics
[6] CWA Membership Reports, Jan. 2002 and October 2003.
[7] NPRM, 3.
[8] *Id.*, 52.
[9] *Id.*, 68.

based on financial book lives, not regulatory lives. Finally, as the Commission stated in the Triennial Review Order, the cost of capital built into UNE prices must reflect the risks associated with a highly-competitive market, including the risk of losing customers to other carriers.[11]

The evidence is clear that competition is alive and thriving in the market for local telecommunications services. According to the Commission's most recent *Local Competition Report*, there are more than 136 million wireless subscribers who are direct competitors to wireline voice telephony, especially with the advent of wireless-to-wireline Local Number Portability. A November, 2002 survey by IDC, an independent market research firm, found that one-quarter (27 percent) of wireless users report that they use their wireless phones at least as often as they use their landline phone for local calls. Ten percent reported that they use their wireless phone more often than they use their wireline phones for local calls.

There are 25 million customers who get their local phone service from a competitive local exchange carrier (CLEC). In the broadband market, cable is beating wireline DSL two to one. Considering all potential voice telecommunications technologies as one local market, the incumbent local exchange carriers (ILECs) serve only 52 percent of the local voice market.[12]

In addition, E-mail, instant messaging, and online chat are substitutes for voice telephony. According to Forrester Research, consumers averaged 69 minutes a day in on-line communication, compared to 45 minutes a day on their landline phone.[13]

The entire telecommunications landscape is on the verge of dramatic change with the

---

[10] *Id.*

[11] Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, CC Docket No. o1-338, FCC 03-36, 680, Aug. 21, 2003 (rel) ("Triennial Review Order").

[12] FCC, *Local Competition Report*, June 12, 2003 (based on data as of Dec. 31, 2002); IDC Access Line Study, Nov. 2002.

emergence of Voice over Internet Protocol (VoIP) telephony. UBS Investment Research estimates that the Bells could lose roughly 16 percent of their primary access lines or roughly 40 percent of their "at risk", more highly profitable lines over the next five years to VoIP utilized by cable operators. (This does not include the impact "strong edge-based carriers" such as Vonage.)[14] Another research company, Needham even states: "We believe this type of 'independent" IP telephony will become the dominant form of landline telephony within the next 5-6 years.[15]

In this environment, it is imperative that the Commission revise its TELRIC pricing rules to conform to a forward-looking price methodology that more accurately reflects the realities of the competitive marketplace.

It is now seven years since the Commission adopted its TELRIC pricing rules. The results have been devastating. The current UNE TELRIC prices do not achieve either of the Commission's goals as articulated in the *Local Competition Order*. The UNE prices do not send efficient entry and investment signals to all competitors, nor do they allow incumbent LECs to recover the forward-looking costs of providing UNES.[16] As a result, the current UNE pricing regime has served to discourage investment by incumbents and competitors alike.

Because UNE TELRIC prices have been based on the forward-looking costs of a hypothetical and not the actual network, the prices do not allow incumbent carriers to recover their costs plus a reasonable profit. The result has been a dramatic decline in capital investment by the four Bell companies since 2001. Below-cost TELRIC prices depress incumbent

[13] Forrester Research, North American Consumer Technographics – Ready for Richer Communications," Sept. 2001.
[14] UBS Investment Research, VoIP in Japan and the U.S., September 11, 2003.
[15] Needham, Equity Research Note July 31, 2003
[16] NPRM, 38.

investment in two ways. First, because the incumbents do not recover their full cost of service, there is less cash flow available to finance infrastructure investment. Second, incumbents are reluctant to invest when the investments will benefit their competitors, who re-sell the service at below-cost prices. According to a report by noted economists Kenneth Arrow, Gary Becker, Dennis Carlton and Robert Solow

> Competition can stimulate investment by giving firms an incentive to develop a product or service that is preferred to that offered by competitors and potential competitors. The incentive effect of competition is weakened if a firm must sell its new technologies, equipment or facilities to competitors at prices that do not compensate for the risk that those investments will result in products or services that fail in the marketplace…
>
> There is a significant risk that competition based on resale of ILEC services or on the use of unbundled elements of ILEC networks will not provide the appropriate incentives for investment. ILECs' incentives to invest are reduced if the resale rates do not compensate them for the costs and risks they face.[17]

Based on company financial reports to the Securities and Exchange Commission, CWA calculates that over the past two years, the four Regional Bell Operating Companies have reduced capital spending by a cumulative total of $30 billion.

Regional Bell Operating Company Capital Expenditures, 2001 – 2003
$ millions

	2001	2002	2003 (est)*	2002 compared to 2001	2003 compared to 2001	Cumulative Change over 2 years
SBC	$ 11,189	$ 6,808	$ 4,407	$ (4,381)	$ (6,782)	$ (11,163)
Verizon	$ 17,371	$ 11,984	$ 11,095	$ (5,387)	$ (6,276)	$ (11,663)
Qwest	$ 4,724	$ 2,863	$ 4,395	$ (1,861)	$ (329)	$ (2,190)
BellSouth	$ 5,997	$ 3,785	$ 2,808	$ (2,212)	$ (3,189)	$ (5,401)
Total	$ 39,281	$ 25,440	$ 22,705	$ (13,841)	$ (16,576)	$ (30,417)

Source: Company SEC 10K and 10Q reports
2003 (est) based on 3Q03 data, extrapolating for fourth quarter

[17] Kenneth Arrow, Gary Becker, Dennis Carlton, Robert Solow, Lexecon Report ("Lexecon Report"), Nov. 18, 2003, 8 (available at http://lexecon.com/documents/Publications/1/9/5/VZTECH_Report_Nov_18.pdf).

Below-cost TELRIC pricing also reduces network investment by competitive local exchange carriers. CLECs' investment incentives are reduced if they can use the ILECs investments at prices below the true cost of use.[18] After all, why would a rational CLEC build its own facilities when it is cheaper to rent them?

FCC data show reduced facilities-based competition by CLECs over the past two years as they have shifted to resale competition, arbitraging below-cost TELRIC prices. UNE-P lines grew over 200 percent in the 2000-2002 period at the same time that facilities-based competitive lines grew just 23 percent. The number of competitive facilities-based non-cable lines decreased from 4.1 million at the end of 2000 to 3.4 million by the end of 2002.[19]

As the Commission has noted, "it is only through owning and operating their own facilities that competitors have control over the competitive and operational characteristics of their service, and have the incentive to invest and innovate in new technologies that will distinguish their services from those of the incumbents."[20] For, "only by encouraging competitive LECs to build their own facilities or migrate toward facilities-based entry will real and long-lasting competition take root in the local market."[21]

Resale does not provide new technologies and services, since the CLEC's are simply riding on the incumbents' network.

> When rivals invest in their own facilities, ILECs will be motivated to upgrade their networks by fear of competition from rivals that might offer new products and services

[18] *Id.*
[19] FCC, *Local Competition Report: Status as of December 31, 2002,"* June 2003.
[20] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* 15 FCC Rcd 3696 (1999), 7.
[21] *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* Fourth Report and Order, CC Docket No. 98-147, FCC 01-204, Aug. 2, 2001 (rel), 4.

using their own facilities. Resale competition can only promote competition in marketing and customer services (and other economic functions performed by the reseller), not in the provision of network services and the development of new services.[22]

Moreover, if UNE prices do not allow incumbents to recover the forward-looking actual costs of the network, service to all customers will decline due to reduced funds available for repair, maintenance, and upgrading of the incumbents' network and employment cuts. Quality service requires sufficient staffing. But over the past two years, the four Bell companies have reduced frontline occupational staffing represented by CWA by 48,000 employees, or 16 percent. (These figures do not include occupational employees represented by other unions and management cuts.)

Reduced capital expenditure by incumbents and competitors has had a devastating impact on telecommunications equipment manufacturers. CWA represents employees at Lucent and Avaya. Over the past two years, these two firms have slashed occupational employment by 60 percent. Absent a change in policy to incent telecommunications network investment, the U.S. is at risk of losing its lead in this critical industry.

CWA-Represented Frontline Employment
Regional Bell Operating Companies, 2002 to 2003

	Jan-02	Oct-03	Change	% Change
SBC	119,763	101,770	(17,993)	-15.0%
Verizon	89,838	71,584	(18,254)	-20.3%
Qwest	35,627	27,386	(8,241)	-23.1%
BellSouth	53,199	49,708	(3,491)	-6.6%
AT&T	26,750	20,306	(6,444)	-24.1%
Lucent/Avaya	20,546	7,895	(12,651)	-61.6%
Total	345,723	278,649	(67,074)	-19.4%

Source: CWA Membership Reports

[22] Lexecon Report, 8-9.

Consumers may benefit in the short-run from below-cost TELRIC pricing rules. But these short-term gains comes at the expense of long-run innovation and the financial health of the industry. Reduced investment leads to poor quality on today'networks and delayed deployment of advanced networks. Given the depression in the telecom sector and the importance of this sector to this nation's economic future, it is especially imperative that the Commission act expeditiously to reform its TELRIC UNE-pricing rules. The Commission should require forward-looking UNE prices be based on network assumptions that account for real-world routing and topography, the reality that networks are built over a period of time, depreciation based on financial book lives, and cost of capital commensurate with today's highly competitive local market.

Respectfully submitted,

George Kohl
Assistant to the President and Director of Research
Communications Workers of America

Dated: December 16, 2003